

Office of Chief Counsel  
Internal Revenue Service

**memorandum**

CC:WR:PNW:HON:TL-N-3587-00  
CKMuranaka

date: JUN 13 2000

to: Denis Nonaka  
Revenue Agent EX:1307

from: Pacific-Northwest District Counsel  
Carol K. Muranaka, Attorney, Honolulu

subject: [REDACTED]

DISCLOSURE STATEMENT

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Facts

[REDACTED] (hereinafter referred to as "[REDACTED]") is a corporation that files consolidated federal income tax returns with its subsidiaries. [REDACTED] wholly owns [REDACTED] (hereinafter referred to as "[REDACTED]"), which in turn, wholly owns [REDACTED] ([REDACTED]). [REDACTED] is engaged in the business of [REDACTED], which involves the transfer of containers and other cargo between vessels and motor and rail carriers. Its parent company, [REDACTED] is a [REDACTED] carrier. [REDACTED] derives approximately [REDACTED]% of its business from [REDACTED].

In [REDACTED], an Accelerated Issue Resolution (AIR) closing agreement was executed between [REDACTED] and its subsidiaries and the Internal Revenue Service on the question whether the depreciation of certain terminal assets belonging to [REDACTED], a subsidiary of [REDACTED], should be depreciated under Asset Class 44.0, Water Transportation (as set forth in Rev. Proc. 87-56, 1987-2 C.B. 674), requiring a fifteen-year life or under Asset Class 57.0, Distributive Trade and Services, requiring only a five-year life. The parties reached a compromise and agreed that [REDACTED] container moving equipment (including gantry cranes, straddle carriers, toplifts, and sidepicks) could be depreciated as seven-year property under Rev. Proc. 87-56 as "Certain Property For Which Recovery Periods Assigned--A. Personal Property With No Class Life."

It is proposed that the following depreciation adjustments be made:

Depreciation

[REDACTED] depreciation adjustm.

\$

\$

The taxpayer claimed depreciation for the following asset additions in [REDACTED] using a 5-year life, DDB, half-year convention:

	<u>Basis</u>
1. [REDACTED]	\$ [REDACTED]
2. [REDACTED]	
3. [REDACTED]	
4. [REDACTED]	
5. [REDACTED]	
6. [REDACTED]	
7. [REDACTED]	
8. [REDACTED]	
9. [REDACTED]	
10. [REDACTED]	

The taxpayer now claims that the equipment is being used in terminal activities, therefore, it should be depreciated over seven years, using the compromise class life in the previous cycle.

#### Issue

The question is whether the foregoing property should be depreciated as water transportation assets (class 44.0), which class requires a 15-year life. The taxpayer believes that the assets should be depreciated under the 7-year life, class A, "Personal Property With No Class Life."

Discussion

I.R.C. § 167 allows as a depreciation deduction a reasonable allowance for the exhaustion, wear, and tear of property used in a trade or business.

I.R.C. § 168(a) provides that the depreciation deduction permitted by section 167(a) for any tangible property shall be determined by using -

- (1) the applicable depreciation method,
- (2) the applicable recovery period, and
- (3) the applicable convention.

The recovery periods mentioned in I.R.C. § 168 are established in Rev. Proc. 87-56, 1987-2 C.B. 674 for tangible property placed in service after 1986. Rev. Proc. 87-56 divides the asset classes into two broad categories: (1) asset classes 00.11 through 00.4 that consist of specific depreciable assets used in all business activities; and (2) asset classes 01.1 through 80.0 that consist of depreciable assets used in specific business activities.

Asset Class 44.0, Water Transportation as described in Rev. Proc. 87-56, includes "assets used in the commercial and contract carrying of freight and passengers by water except the transportation assets included in classes with the prefix 00.2." All related land improvements are included.

In Standard Industrial Classification Manual (hereinafter referred to as "SIC") published by the Office of Management and Budget, Major Group 44-Water Transportation, is described as including:

establishments engaged in freight and passenger transportation on the open seas or inland waters, and establishments furnishing such incidental services as lighterage, towing and canal operation. Cargo handling operations when carried on by transportation companies and separately reported are classified in Industry No. 4463. When separate reports for cargo handling are not available, these operations are classified with the transportation establishment.

Industry No. 4463 is described in SIC includes establishments primarily engaged in activities directly related to marine cargo handling from the time cargo, for or from a vessel, arrives at shipside, dock, pier, terminal, staging area, or in-transit area until cargo loading or unloading operations are completed.

It is indisputable that cargo handling/terminal operations are an essential part of the water transportation business activity. Support for this conclusion is found in the SIC classification scheme. In SIC, cargo handling is specifically associated with water transportation. See Industry No. 4491. Moreover, if [REDACTED] treated its terminal operations as a separate business activity for asset classification purposes, it would be inconsistent with the holding of Rev. Rul. 77-476, 1977-2 C.B. 5.

Rev. Rul. 77-476, 1977-2 C.B. 5 involves an electric utility that owned a 50-mile pipeline through which it transported oil for use at its generating facility. The ruling notes that the taxpayer is in the business of producing and selling electricity and does not have a separate trade or business activity of transporting oil or other goods by pipeline. Therefore, the ruling holds that all of the taxpayer's assets are includible in asset guideline class 49.13, Electric Utility Steam Production Plant, and that the pipeline transportation assets cannot be separately classified in asset guideline class 46.0, Pipeline Transportation.

In Tennessee Natural Gas Lines v. Commissioner, 71 T.C. 74 (1978), a case that was cited by A & B in the previous cycle in support of their position, the taxpayer contended that a portion of its liquified natural gas storage facility should be includible in Asset Class 49.23, Natural Gas Production Plant, rather than Asset Class 49.24, Trunk Pipelines and Related Storage Facilities. In discussing "primary use" under Treas. Reg. section 1.167(a)-11(b)(4)(ii)(b), the court stated that the deciding factor is the use to which the asset is put rather than the nature of the equipment or the manner in which the asset operates. The court noted that the entire facility was used to make natural gas suitable for storage.

In this case, the sole use of the entire LNG facility is to make natural gas suitable for storage. Marketable natural gas enters the facility, is stored, and approximately the same volume of marketable natural gas leaves the facility when the gas is needed for consumption. In no way is a marketable product produced by the LNG facility---a marketable product is merely stored there.

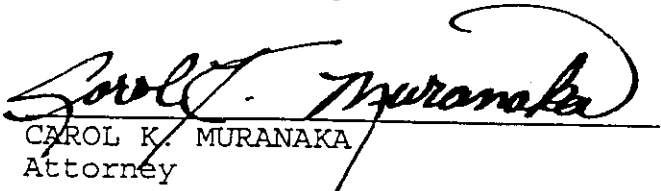
Id. at 94.

It should be noted that in the previous cycle, the taxpayer had contended that [REDACTED] was in a separate and distinct business from [REDACTED], which owned it. [REDACTED] was in the business of cargo handling and not in the water transportation business as [REDACTED]. Because of that distinction and the

potential litigating hazards, a settlement was reached to allow [REDACTED] to depreciate its assets using a 7-year period. Here, although the small number of subject assets are similar to those that were depreciated by [REDACTED], it would not be appropriate to allow the taxpayer a similar compromise to 7 years. The assets here are primarily used by [REDACTED] to conduct its water transportation business. Accordingly, these assets are properly includible in Asset Class 44.0 and depreciated over a 15-year period.

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By:

  
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